

# NOTES TO FINANCIAL STATEMENTS

For the Fiscal Year Ended June 30, 2002

## NOTE 1 - Summary of Significant Accounting Policies

The accompanying financial statements of the Local Government Investment Pool (LGIP) have been prepared in conformity with accounting principles generally accepted in the United States of America. The Office of Financial Management (OFM) is the primary authority for the state's accounting and reporting requirements. OFM has adopted the pronouncements of the Governmental Accounting Standards Board (GASB) which is the accepted standard-setting body for establishing governmental accounting and financial reporting principles nationally. For proprietary fund accounting and reporting, the state applies applicable pronouncements of the Financial Accounting Standards Board issued on or before November 30, 1989, unless those pronouncements conflict with or contradict the pronouncements of the GASB. The more significant of the LGIP's accounting policies are as follows:

**Reporting Entity** - The LGIP is an investment trust fund (a fiduciary fund) of the state of Washington. The assets and liabilities of the LGIP are included in the Comprehensive Annual Financial Report of the state of Washington. However, the accompanying financial statements present only the LGIP and are not intended to present fairly the financial position of the state of Washington and the results of its operations in conformity with accounting principles generally accepted in the United States of America. Although legally separate, the LGIP is governed by the State Finance Committee and is administered by the state treasurer.

**Measurement Focus and Basis of Presentation** - These separately issued financial statements are presented for LGIP participants. The LGIP is an investment trust fund that reports transactions and balances using the economic resources management focus and the accrual basis of accounting. Under this method, revenues are recorded when earned, and expenses are recorded at the time liabilities are incurred.

**Description of the LGIP** - The LGIP was created by Chapter 294, Laws of 1986 and began operations in July 1986. This short-term investment pool is available to Washington State counties, cities, towns, municipal corporations, political subdivisions, special-purpose taxing districts, community and technical colleges, the State Board for Community and Technical Colleges, and the State Finance Committee. Participants are permitted separate accounts for bond proceeds to facilitate arbitrage calculation.

**Investment and Certificates of Deposit Activity** - The policy of the LGIP is to invest in high-quality, short-term instruments. All money market securities are required to be rated A-1 by Standard and Poor's Corporation and P-1 by Moody's Investors Services, Inc. Investments are restricted to securities that mature in 397 days or less, and the portfolio maintains a weighted average maturity of 90 days or less. The state treasurer has the sole responsibility to set investment strategy for the LGIP.

Investments are valued at amortized cost, which approximates fair value. Certificates of deposit are valued at historical cost. Security transactions are reported on a trade date basis following accounting principles generally accepted in the United States of America. Pending purchases, as of June 30, 2002, settled at a total cost of \$50,933,594 on July 1, 2002. Securities with a maturity of June 30, 2002, settled on July 1, 2002 for \$103,187,500, which includes accrued interest.

**Income Recognition** - Interest income on portfolio investments is accounted for on the accrual basis.

**Deductions and Penalties** - An administrative deduction is assessed for the administration of the LGIP in accordance with WAC 210-01-120. The deduction is set so as to cover costs associated with the LGIP. The deduction is calculated at 0.035 percent of each participant's average daily balance of the funds in the LGIP and is reflected on the participant's monthly statement. The deduction is subtracted from the pool participant's earnings prior to the earnings posting to the account. The amount assessed for administration of the LGIP totaled \$1,872,978 for Fiscal Year 2002.

On a monthly basis, the LGIP determines the total dollar amount necessary to reimburse the state treasurer's office for actual expenses as provided in RCW 43.250.060. Administrative deductions collected in excess of these expenses are rebated to pool participants at the end of each fiscal year. The proportionate share of the rebate is based on the participant's average daily balance for the fiscal year. The rebate totaled \$1,385,401 for Fiscal Year 2002.

The net administrative deduction for Fiscal Year 2002 was 0.009 percent of each participant's average daily balance of the funds in the LGIP.

Overdraft penalties due to failure to wire funds by a pool participant (after notification to the state treasurer of an intended transfer) are assessed to the pool participant responsible for the overdraft. Overdraft penalties collected (miscellaneous income) are allocated and distributed to participants on an annual basis, based on the participant's average daily balance for the fiscal year. Overdraft penalties totaled \$3,886 for Fiscal Year 2002.

**Participant Transactions** - Participants can invest and withdraw their investments on a daily basis with a limit of one transaction per business day. The minimum transaction amount is five thousand dollars. There is no maximum transaction amount. For an investment or withdrawal of ten million dollars or more, a one-day notification prior to the transfer date is requested. An investment or withdrawal greater than one million dollars requires notification prior to 9 A.M. on the transfer date. An investment or withdrawal of one million dollars or less requires notification prior to 10 A.M. on the transfer date. All participants are required to file with the state treasurer a certified copy of an ordinance or resolution containing the names and titles of the officials authorized to invest or withdraw funds in the LGIP.

Distributions to local governments for state, federal, and local revenues electronically transferred utilizing the state treasurer's distributions system can be directly invested in the LGIP. These investments are in addition to the one transaction per business day limit.

**Income Distribution to Participants** - Net investment income is distributed monthly to participants and is based on their average proportionate share of net assets in relation to the total net investment income of the LGIP for that month. Distributions are reinvested in the LGIP.

**Service Providers** - The state treasurer oversees the operations of the LGIP and provides portfolio management and record keeping services. The costs for these services, together with professional fees, custodian fees, and other operating costs, are charged to the LGIP as an expense.

Since October 1, 2000, the Bank of New York has provided securities lending services for the LGIP and served as securities custodian, maintaining custody of all LGIP-owned investments other than certificates of deposit.

**Risk Management** - The state of Washington continues to operate a risk management liability program pursuant to RCW 4.92.130. The state manages its tort claims as an insurance business activity rather than a general governmental activity. The state's policy is generally not to purchase commercial insurance for the risk of losses to which it is exposed. Instead, the state management believes it is more economical to manage its risks internally and set aside assets for claims settlement in an Internal Service Fund. A limited amount of commercial insurance is purchased for employee bonds and to limit the exposure to cata

strophic losses. Otherwise, the risk management liability program services all claims against the state for injuries and property damage to third parties. The Office of the State Treasurer participates in the risk management liability program.

**Securities Lending** - In accordance with GASB Statement 28, the LGIP reports securities lent (the underlying securities) as assets in the statement of net assets. Cash received as collateral on securities lending transactions and investments made with that cash are reported as assets. Securities received as collateral are reported as assets if the LGIP has the ability to pledge or sell them without a borrower default. Liabilities resulting from these transactions are reported in the statement of the net assets. Securities lending transactions collateralized by securities that the LGIP does not have the ability to pledge or sell unless the borrower defaults are not reported as assets and liabilities.

**2a7- Like Pool** - In accordance with GASB Statement 31, the accounting and financial reporting standards in paragraphs 7, 8, and 10 through 15 apply to all investments of governmental external investment pools, except that 2a7-like pools may report their investments at amortized cost. The LGIP is a 2a7-like pool, therefore, investments will continue to be reported at amortized cost.

## **NOTE 2 - Investments and Deposits**

The LGIP's investments are categorized below per GASB Statement 3 to give an indication of the level of risk assumed at year-end. GASB Statement 3, Category 1, includes investments that are insured, registered, or held by the LGIP or its agent in the LGIP's name. GASB Statement 3, Category 2, includes uninsured and unregistered investments which are held by the counterparties' trust departments or agents in the LGIP's name. GASB Statement 3, Category 3, includes uninsured and unregistered investments held by counterparties or their trust departments or agents, but not in the LGIP's name.

The LGIP had no investments in Categories 2 or 3 on June 30, 2002. At year end, investments by investment type are as follows:

<b>Investment Type</b>	<b>Category 1</b>	<b>Fair Value</b>
Repurchase Agreements	\$ 458,043,000	\$ 458,043,000
U.S. Agency Coupons		
Not on Securities Loan	20,006,340	20,006,340
On Securities Loan	30,903,140	30,903,140
U.S. Agency Discount Notes	3,220,080,074	3,220,080,074
U.S. Treasury Securities		
Not on Securities Loan	1,055,005,967	1,055,005,967
On Securities Loan	<u>642,792,203</u>	<u>642,792,203</u>
<b>Sub Total</b>	5,426,830,724	5,426,830,724
Securities Lending		
Repurchase Agreements	683,155,372	683,155,372
Commercial Paper		
Due from Brokers - Securities Purchased But Not Settled		
U.S. Agency Discount Notes	50,933,594	50,933,594
Due to Brokers – Securitites Matured But Not Settled		
U.S. Treasury Securities	<u>(100,000,000)</u>	<u>(100,000,000)</u>
<b>Total Investments</b>	<u>\$6,060,919,690</u>	<u>\$6,060,919,690</u>

State statutes permit the LGIP to lend its securities to broker-dealers and other entities with a simultaneous agreement to return the collateral for the same securities in the future. The LGIP, which has contracted with a lending agent to lend securities in the LGIP, earns a fee for this activity. The lending agent lends securities and receives collateral, which can be in the form of cash or other securities. The collateral, which must be valued at 102 percent of the fair value of the loaned securities, is priced daily and, if necessary, action is taken to maintain the collateralization level at 102 percent. The cash is invested by the lending agent in repurchase agreements or money market instruments, in accordance with investment guidelines approved by the LGIP. The securities held as collateral and the securities underlying the cash collateral are held by the LGIP's custodian. At June 30, 2002, all LGIP securities on loan were collateralized by cash and other securities and are classified in the preceding schedule of custodial credit risk according to the category for the collateral received on the securities lent. On June 30, 2002, the average life of both the loans and the investment of cash received as collateral was one day.

The LGIP investment policy requires that any securities on loan be made available by the lending agent for next day liquidity at the option of the LGIP. During Fiscal Year 2002, the LGIP had no credit risk exposure to borrowers because the amounts owed to the borrowers exceeded the amounts the borrowers owed the LGIP. Furthermore, the contract with the lending agent requires them to indemnify the LGIP if the borrowers fail to return the securities (and if collateral is inadequate to replace the securities lent) or if the borrower fails to pay the LGIP for income distribution by the securities' issuers while the securities are on loan. The LGIP cannot pledge or sell collateral securities received unless the borrower defaults. The LGIP investment policy limits the amount of reverse repurchase agreements and securities lending to 30 percent of the total portfolio. There were no violations of legal or contractual provisions nor any losses resulting from a default of a borrower or lending agent during the year.

Repurchase agreements are collateralized at 102 percent. The collateral is priced daily and held by the LGIP's custodian in the state's name. Collateral for mortgage-backed repurchase agreements with a maturity date longer than seven days will be priced at 105 percent of fair value, plus accrued interest. Collateralized Mortgage Obligations (CMO) used as collateral for repurchase agreements must pass the Federal Financial Institutions Examination Council (FFIEC) test, or not exceed a volatility rating of V-5 by Fitch Investor Services, or a similar rating of a nationally recognized rating agency.

State law also permits the LGIP to enter into reverse repurchase agreements, which are, by contract, sales of securities with a simultaneous agreement to repurchase them in the future at the same price plus a contract rate of interest. The fair value of the securities pledged as collateral by the LGIP underlying the reverse repurchase agreements normally exceeds the cash received, providing the dealers a margin against a decline in the fair value of the securities. If the dealers default on their obligations to resell these securities to the LGIP or to provide equal value in securities or cash, the LGIP would suffer an economic loss equal to the difference between the fair value plus accrued interest of the underlying securities and the agreement obligation, including accrued interest. On June 30, 2002, there were no obligations under reverse repurchase agreements.

A derivative is a futures, forward, swap, or option contract, or other financial instrument with similar characteristics. The LGIP did not own, buy, or sell derivatives during the year.

Deposits by type, at June 30, 2002, are as follows:

Type of Deposit	<u>Reported Amount</u>	<u>Insured/ Collateralized</u>	<u>Uninsured/ Uncollateralized</u>
Demand Deposit	\$ (1,999,232)	\$ (1,999,232)	\$.....
Certificates of Deposit	<u>144,050,000</u>	<u>144,050,000</u>	<u>.....</u>
<b>Total Deposits</b>	<u>\$142,050,768</u>	<u>\$142,050,768</u>	<u>\$.....</u>

All LGIP's deposits are either insured or collateralized. The LGIP's insured deposits are covered by the Federal Deposit Insurance Corporation (FDIC). Collateral protection is provided by the Washington Public Deposit Protection Commission (PDPC). The PDPC, created by the Legislature per Chapter 39.58 of the Revised Code of Washington, constitutes a multiple financial institution collateral pool. Pledged securities under the PDPC collateral pool are held by the PDPC's agent in the name of the collateral pool.

### **NOTE 3 - Summary of Activity**

A summary of LGIP activity, including reporting required by RCW 43.250.080, is as follows:

	<b><u>FY 2002</u></b>
Total Investment Purchases	\$101,639,264,716
Total Sales	\$8,120,916,127
Total Maturities	\$93,281,469,000
Total Net Income	\$138,996,543
Administrative Expenses	\$487,577
Portfolio Yield (360-Day Basis)	2.61 percent
Average Weighted Maturity	42 days
Pool Participants Investments	\$12,956,626,609
Pool Participants Redemptions	\$12,654,682,443

### **NOTE 4 - Related Party Transactions**

State of Washington funds pursuant to RCW 43.250.020(4)(b) may be invested in the LGIP. As a pool participant in the LGIP, activity and balances for state of Washington funds (community colleges and State Finance Committee) were as follows:

<b>Increase in Net Assets From Operations</b>	<b><u>FY 2002</u></b>
Income Distributed and Deposited to Participants	
Accounts at Net Asset Value of \$1.00 per Unit,	
Net of Administrative Deductions of \$44,264	<u>\$ 3,271,972</u>
<b>Pool Participants Unit Transactions at Net Asset Value of \$1.00 per Unit</b>	
Purchase of Units	773,862,029
Redemption of Units	<u>761,040,833</u>
Net Increase	<u>12,821,196</u>
<b>Total Increase in Net Assets</b>	16,093,168
<b>Net Assets</b>	
<b>Beginning of Year</b>	<u>142,457,324</u>
<b>End of Year</b>	<u><u>\$ 158,550,492</u></u>